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THE ALDRICH BANKING PLAN

Senator Aldrich's plan has the merit of suggesting remedies for the most fundamental defects in our currency system, namely: its lack of elasticity; the uneconomical use of banking reserves, their connection with the stock market, and their control by Wall Street; the lack of a ready and sure market for first class commercial paper through which banks can liquidize their best resources at any and all times; the lack of a form of commercial bill which bears on its face evidence of its character and genuineness; and the disturbing influence of our independent treasury system. The means proposed to remedy these defects are the following:

A central institution in Washington, with fifteen branches, situated one in each of fifteen districts into which the country is to be divided, endowed with the following rights and privileges: (1) that of gradually absorbing the present issue privileges of the national banks, of ultimately securing these issues by legal currency and first class commercial paper instead of bonds, and of issuing additional notes secured in the same manner on the payment of a graduated tax; (2) that of serving as reserve agent for national banks, of rediscounting for them high grade commercial paper of short maturity and of transferring funds for them between the main offices and the branches or between the branches; and (3) that of serving as depository and banker for the federal government. It provides that this institution shall be under the joint control of the officers and directors of national banks, the federal government and the various business interests of the country, with the balance of power in the hands of the national banks. It also provides that national banks be given the right under certain restrictions to accept bills for their customers, and that two new classes of national banks be authorized endowed with privileges approximating those now possessed by state banks and trust companies.

If such an institution should succeed in becoming the sole bank of issue in the country, under the conditions proposed, and the reserve and transfer agent for the national banks, it would be in a position to supply the elastic element now needed in our currency, and it would greatly increase the efficiency of our banking reserves. The basing of issues upon commercial paper and the placing of control in the hands of the government and the banks would sever the

connection at present existing between our central reserve system and the stock market, and would remove it from the control of Wall Street. The privilege of accepting bills for customers, if generally made use of by national banks and business men, would create a new form of commercial paper of high grade, the so-called bankers' bill, and the rediscount privilege provided by the plan would create a ready market for such bills, thus enabling national banks to liquidize a considerable portion of their reserves at any and all times. Since the proposed institution is to be the depository and banker of the government, the evil effects of our present independent treasury system would be avoided.

The query raised by a study of this plan is whether it will actually "work out" in the manner indicated. In this connection it will be well to determine first of all what banks are likely to take advantage of it, if the privilege is offered them. No form of compulsion is proposed. No bank is to be compelled to buy stock in the new concern, or to sell bonds to it or to use it as a reserve agent. Whether or not a given bank will enter the proposed system seems, therefore, to depend entirely upon the strength of the inducements offered. These are four in number: the discount privilege; that of counting balances as reserves; that of securing transfers between the different branches and between the branches and the central institution at Washington; and that of obtaining shipments of notes from the bank or its branches without expense. As offsets to these inducements must be counted the loss of interest now paid by reserve agents, the new institution not being permitted to pay interest on balances; the necessity of tying up twenty per cent of the capital in the stock of the Reserve Association; and the fact that the maximum dividends allowed, five per cent, are below the earnings of the capital of many, if not most, banks on the investments into which they would otherwise put their capital.

How strong these inducements will prove to be, diminished as they must be by these offsets, can only be conjectured, but since the character and influence of the proposed institution depends almost entirely upon them the probabilities in the case must be considered.

In estimating the value of the privilege of rediscounting with the Reserve Association, banks will consider the frequency and urgency of the occasions on which they are likely to want to take advantage of it and the ease or difficulty and expense of availing themselves of it. In this connection experience will needs be their chief guide.

What will that teach? In the case of most banks, especially those outside the reserve cities, that in ordinary times they will rarely need it, but that on extraordinary occasions, such as a crisis, the possession of it would save them much anxiety and that its occasional use would, therefore, be probable; in the case of banks in the reserve cities, especially those that carry large bankers' balances, that its use in the spring and fall, at the beginnings of the quarters and on other occasions when the demands upon them for currency are above the average, would also be advantageous. Reckoned in dollars and cents the value of this privilege to any bank would be the interest on the idle funds it would otherwise need to hold in order to meet the varying and extraordinary demands made or likely to be made upon it. With the rediscount privilege banks could safely hold bankable paper for these purposes instead of idle funds.

The cost of using this privilege, reckoned in time, trouble and money, will count as an offset to the value placed upon it. In the case of country banks this will be rather high. In the first place only short paper can be used and the amount of that available to them is relatively small. In the next place they must establish, to the satisfaction of the officers of their local association, the high character of the paper submitted and for this purpose they will lack in most cases the detailed statements and other data which large banks in commercial centers, having well organized credit departments, possess. They must also pay a fee for the endorsement of the local association. Their distance from the seat of their local association will also serve as an obstacle, as well as their distance from the nearest branch to which the paper must be sent before any returns on it can be secured. Since there are to be only fifteen branches for a country so large as ours, these distances are bound to be considerable in most cases.

In the case of most, if not all country banks, it seems not improbable that these costs will nearly or entirely balance their estimate of the value of this privilege. It is also highly probable that under the new regime their correspondents in the reserve cities would be able and willing to offer them rediscount privileges which would be more attractive than those at the disposition of the proposed Reserve Association. For the banks in the reserve cities the balance of advantage in favor of making use of the Reserve Association would be considerably greater.

The value of the privilege of counting balances with the Reserve

Association as legal reserves will depend very much on the policy pursued by the new institution relative to collections. That policy will needs be considerably more liberal than the one pursued by their present reserve agents in order to induce country and reserve city banks to transfer their balances. By such transfers they will lose two or more per cent interest at present received. In all probability whatever terms the new institution makes regarding collections will be duplicated by existing reserve agents in order to hold their bank customers. If, then, banks generally make use of this privilege at all, it will be because no limit is to be placed upon the amount of such balances they can count as reserves, whereas now country banks can count balances with their reserve agents only to the extent of three-fifths, and reserve city banks to the extent of one-half, of their legal reserves; or because the other inducements offered are great enough to counterbalance the loss of interest involved. The advantage of carrying a balance with the nearest branch of the Reserve Association instead of cash in the vaults will not be great under ordinary circumstances, except in the cases of large banks located in the same towns as the branches or very near them. In the case of banks in the central reserve cities the advantage of being able to shift the responsibility of meeting the demands for cash now made upon them from all sections of the country would be great enough to make it worth while to keep large balances with the Reserve Association; and it is also probable that the sum total of the advantages in being a part of the new system would induce the reserve city banks to do likewise, but it is hardly probable that the country banks would find it profitable to do so.

If the new Association could actually maintain branches in every one of the fifteen sections into which the country would be divided, it would have an advantage over any of its competitors in the capacity of transfer and collection agent. It could then easily and economically serve as a clearing house for the entire country, and drafts upon it would speedily acquire universal currency. The obligation imposed by the Aldrich plan of sending its notes free of charge upon demand to any bank having a balance with it would also give it an advantage over competitors who now compel customers to pay the cost of currency shipments. It is probable, however, that banks in reserve and central reserve cities, who now perform these functions to the satisfaction of their banking customers, would meet the competition of the new institution along

these lines, even though it would involve expense and a consequent lowering of profits.

The above considerations strongly suggest the probability that the country banks would not in large numbers take advantage of the opportunities offered by the plan. Without materially changing their present connections they would indirectly reap advantages from it by securing from their present correspondents rediscount privileges and better terms in respect to collections and currency shipments. Confined in its operations to banks in the reserve cities and to a few others outside, who do a fairly large business in bankers' balances, the query arises whether all the features of the plan could be carried out. In this case it should be noted that the capital of the Association would be about \$80,000,000, assuming that all the national banks in all the reserve cities would purchase stock. With that amount could it safely assume the obligation placed upon it of offering for the period of one year to purchase the two per cent bonds now held by national banks? According to the report of the comptroller of the currency for Oct. 31, 1910, these amounted to \$580,145,400. If all these should be offered for sale within the year, it is obvious that the Association could pay for them only by using, in addition to its capital, funds left with it on deposit. After the lapse of a sufficient amount of time to permit the retirement of the bank notes now issued against these bonds, the notes of the Association would also be available; but in the mean time a considerable portion, and unless they should be much larger than could be reasonably expected, a large portion of the deposits would be tied up in bonds, which according to the plan could not be sold until after the lapse of two years and then only at the rate of \$50,000,000 a year and with the consent of the Secretary of the Treasury. During this interval might not the Association become seriously embarrassed for cash? Even after the notes of the Association had gone into circulation in place of the national bank notes, might not some embarrassment be occasioned by demands for redemption, the Association being powerless, on account of the bonds, to regulate the volume of its issues in accordance with its cash or other resources?

Some other aspects of the note issue feature of the plan may appropriately be considered at this point. Provision is made for the purchase only of the two per cents held by the national banks as security for circulation. It is not made quite clear whether the amount of these bonds so held and purchased is to be the measure

of the amount of notes the Association is to be permitted to issue without payment of a tax of at least 3 per cent, or whether the total issues of the national banks at the time the new Association shall begin operations is to constitute such measure. In either case the query is pertinent whether the untaxed or moderately taxed contingent is placed at a sufficiently high figure. In the one case it would amount to about \$600,000,000 and in the other to about \$750,000,000. The answer to this question will depend upon the part it is designed that bank notes shall play in the future of our monetary system. Shall we depend upon them for the supply of the elastic element in our currency or upon the foreign gold movement or upon both? It is not probable that the foreign gold movement can for a long time, if ever, be our main reliance for this purpose. Our distance from Europe as well as the nature of our foreign commerce and the differences between our credit system and those of Europe will always interfere with its efficiency in this respect. Our Reserve Association could never reasonably expect to rival the Bank of England in its command over the world's supply of gold.

If bank notes must be chiefly relied upon, it is doubtful if the amount of the untaxed contingent suggested in the Aldrich plan is adequate. It should be remembered that it is upon this portion of the authorized issue that we must depend for this purpose. The tax of three per cent or more to be levied upon issues above this amount would be prohibitive except on occasions of rather extreme stringency, and it is for the purpose of avoiding such occasions that an elastic element in the currency is desired. The bank notes at present in circulation constitute a part of the amount of hand-to-hand money needed at all times, those of minimum as well as maximum demand, and unless some other provision is made for supplying their place, the untaxed or low taxed notes of the Reserve Association would be employed and few, if any, would be available to supply the extra seasonal and other demands.

It is, of course, possible that the place of our national bank notes might be wholly or partly filled by gold and, perhaps, this is Senator Aldrich's intention. But the void would not thus be filled unless special provision were made for it and that the plan does not provide. According to the experience of other countries such provision would have to be made by prohibiting the issue of notes below the denominations of twenty or twenty-five dollars, and, probably, by authorizing the issue of gold certificates of de-

nominations below ten dollars. If notes of the Reserve Association are to be issued as fast as national bank notes are retired, and in the same denominations, they would take the place of these notes in the circulating medium, and the entire untaxed or low taxed issue, or nearly all of it, would remain permanently in circulation.

If it should seem desirable considerably to increase the gold element in our circulating medium, there is no good reason, unless it be an overabundant supply of the yellow metal, why the void caused by the retirement of our national bank notes should be wholly so filled, and why the entire future increase in our demand for hand-to-hand money in denominations of from one to twenty-five dollars shall take the form of gold currency. The issues of the proposed Reserve Association might well do a part of this work. If it is desirable that they should, it is doubtful if the amount of untaxed or low taxed issues provided by the Aldrich plan is large enough.

It may be that Senator Aldrich contemplates the supply of an emergency circulation of bank notes only. In that case his plan is open to the criticism of inadequacy. Unless a Reserve Association or Central bank is so organized as to supply the elastic element now lacking in our currency system, many people will not consider it worth having. A much simpler and less expensive scheme could be devised for the supply of an emergency circulation. Furthermore, if we are to have such an institution, it could without serious difficulty be made to perform this function as well as others.

If the country banks should not generally purchase stock in the new institution, it is questionable whether that feature of the plan which contemplates the division of the country into fifteen sections and the location of a branch in each section would prove to be workable. The reserve cities are not properly distributed for the working out of such a scheme. Since, according to the plan, the minimum capital for a local association is placed at \$5,000,000 and the district is to consist of a group of local Associations, there would probably be only *one* branch on the Pacific Coast, *two* in the region between the Mississippi and the Coast, *one* in the South, and *three* or less in the Middle West. The rest would be in the East. Everywhere, except possibly in the East and the Middle West, the distance of banks from the nearest branch would seriously interfere with the establishment of such relations as are necessary, if the central institution is to play an active part in their daily affairs. If it is not to play such a part, then it will become an emergency institution only.

Not only the scheme for branches but also other features of the plan suggest the possibility that it might develop into an emergency institution only. One of these is the limitation of its operations to national banks without permitting any modification in existing reserve requirements other than those which have been mentioned. The central banks of Europe owe a considerable part of their business and their power on the money market to the fact that other banking institutions are permitted to count bankable paper as reserves. These latter institutions ordinarily carry very small amounts of cash, relying upon rediscounts or call or short time loans on this kind of paper as collateral for the replenishment of their supply as needed. The presentation of such paper to the Central bank for discount is thus a regular daily proceeding and every banking institution is obliged to put itself into direct or indirect connection with the Central bank in order to supply its cash demands, the alternative being the keeping on hand of idle funds. Under present reserve requirements our national banks are obliged to keep idle funds on hand and under the Aldrich plan, to the extent that they would use the Reserve Association as their reserve agent, the amount of such funds would be larger than at present on account of the fact that they would receive no interest on their balances. Under these circumstances would they not make the minimum possible use of the Association, and would that not mean that they would use it only in times of stringency, ordinarily transacting their business as they do now?

If, so far as the banks are concerned, the Reserve Association should prove to be simply an emergency institution, would it function properly and would it answer our purposes? Under such circumstances its resources in ordinary times would consist chiefly of the funds paid in by the stockholders and deposited by the Government. The amount deposited by banks would be the minimum permitted as a condition of doing business and probably would not be large. For the investment of these funds there would be available the bonds of the United States, the States, and foreign countries, and such foreign and domestic bills and commercial paper as the Association might be able to induce banks to sell it and as it might purchase on the open market in foreign countries. The only efficient inducement it could offer banks to sell would be a discount rate so low as to leave them a fair margin of profit on the transaction. Such purchases would amount to loans to the banks at a low rate of interest. What profits would be under these conditions can

only be conjectured, but there is a strong probability that they would be small, possibly, and it seems to me probably, so small as to reduce dividends considerably below five per cent. In that case the discrepancy between the earnings of the capital of banks invested in the stock of the Association and what it might produce otherwise invested, would weaken considerably the desire of banks to retain their stock and remain parts of the system.

It would not be safe for the Association to tie up any considerable portion of its resources in bonds, because in that case it would find difficulty in liquidizing them on the occasions on which its services as an emergency institution would be needed. Practically then, in ordinary times, the Association would serve as a middle-man for the loaning of a part of its capital, the deposits of the government and that fraction of bank reserves left on deposit with it, to the banks at a low rate of interest. The liquidizing of these resources in times of emergency would take from the banks funds available to them previously at a low rate of interest. These would then be reloaned to them at a higher rate, a proceeding which would not increase their aggregate resources. The only special assistance the Association could render would be through its note issues. It may be maintained perhaps, gold importation aside, that this is the only possible method by which a central institution can under any circumstances increase the funds available for other banks. This is true in a sense, but there is a difference between taking funds from the banks with one hand and giving them back with the other, and taking funds from the open market and loaning them to the banks. In the one case the central institution operates only after the banks have assumed obligations relative to the market; in the other it is in a position to arbitrate between the banks and the market, the power of control remaining in its hands.

Relative to this matter of control it should be noted that the influence of the proposed institution on the rate of discount would probably be very slight. In ordinary times it would be nil, since the Reserve Association would be a suitor at the doors of the national banks for investments for its funds and would be obliged to accept the terms they might impose, terms which would be dictated by the market rates. In times of actual or threatened stringency, the tables would turn and the banks would be suitors at the door of the Reserve Association, thus temporarily throwing the control into its hands.

Upon this question of control of the market that feature of the

Aldrich plan which pertains to state banks and trust companies has a bearing. These institutions are not to be permitted to establish direct connections with the Reserve Association, but similar institutions organized under federal auspices are to have this privilege. The hope of Senator Aldrich doubtless is that under the conditions proposed state banks and trust companies would exchange their state for national charters. Is such action probable? State pride and the tendency already manifested by the states to develop their systems along independent lines would be opposed and might result in still further widening the gap between the two systems. In that case we would more closely approximate financial chaos than at present, and the influence of the Reserve Association on the rate of discount and in every other respect would be much less than it ought to be if it is to meet the needs of the country.

Persons who suspect that any measure proposed by Senator Aldrich must necessarily be designed to play into the hands of "the interests" will look for a joker in his plan for the management and control of the proposed institution. They will have considerable difficulty, however, in finding it. Wall Street could control the new institution only by absolutely controlling a majority of the banks that will purchase stock in the new institution, and even then its control would be tempered by the influence of the Federal Government and of the representatives of the commercial and industrial world provided for in the scheme. The influence of the Federal Government will be great. The governor and deputy governors are to be appointed by the President, but from a list selected by the board of directors, which list could of course be dictated by Wall Street, if it should control the board. But the power of appointment and removal would give the Government a great advantage in any conflict of interests. The Secretary of the Treasury, the Secretary of Commerce and Labor, and the Comptroller of the Currency are to be ex-officio members of the board of directors, and the latter, as well as the governor and deputy governors, also members of the executive committee. If any criticism is to be passed upon this feature of the plan, it is not the extremely remote possibility of the undue influence of Wall Street but its complexity and cumbersomeness. What kind of a management such a plan would produce it would be extremely difficult even to guess.

In discussing this plan one must not forget that any practical scheme for a central bank must be adapted to actual rather than

ideal conditions. Its design to complete and perfect our present national banking system rather than radically to modify it is commendable. It was doubtless with this in mind that Senator Aldrich proposed to confine the operations of the Reserve Association to the national banks and to avoid the possibility of competition with them. But an institution, with free access to the open market, with the privilege of establishing connections with state banks, trust companies, and other financial institutions and even with private persons, might become the head of our entire banking system, and, in so doing would more efficiently serve the national banks and would tend to weld together, rather than force further apart, our state and national systems. If, in addition to thus broadening the scope of the Reserve Association, our national banks should be permitted to count bankable paper as a part of their reserves, and the Reserve Association should be given the privilege of establishing such branches as experience should determine to be necessary in order properly to serve its constituents, and if its loan operations, as Senator Aldrich proposes, be confined to the highest grades of short time bills and commercial paper, national banks would find it clearly in their interest to purchase stock and connect themselves with the new Association, and the amount of competition they would experience from it would be a negligible quantity.

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